



## Pyramid Schemes

*What Is A Pyramid Scheme?* - Pyramid schemes are illegal moneymaking ventures for individuals, businesses, and small group of people. A typical pyramid scheme involves a few individuals at the top who recruit participants who, in turn, recruit other participants to offer something of value (usually money, but in some cases, time) to the organization. Recruits are offered the promise of large sums of money if they successfully bring in others to pay money to join the pyramid. Pyramid schemes focus on the exchange of money and recruitment. Usually, there is no legitimate product being sold.

*How Are Pyramid Schemes Disguised?* - Pyramid schemes may be disguised as games, chain letters, buying clubs, motivational companies, mail order operations, or investment organizations. Although some pyramid schemes call themselves multi-level marketing operations, not all multi-level marketing companies are pyramids. When the emphasis is on recruiting new members rather than selling something of value, the organization is probably an illegal pyramid.

*How Do Pyramid Schemes Work?* – Basically, a pyramid scheme is formed when a single promoter (or small group of promoters) collects money from a certain number of “friends” and instructs them to collect more money from more of their “friends.” The cycle goes on from there. As the pyramid grows, the number of people involved becomes too large to sustain the pyramid. Some people will fail to send in their money or recruit the required number of “friends,” and the pyramid crumbles. The majority of people end up on the “bottom” of the pyramid and inevitably will lose their initial

“investment.” They will not get their money back or earn their promised fortune because no one is beneath them in the pyramid adding new money to the pot.

*Why Do Pyramid Schemes Fail?* – Pyramid schemes collapse when a few people drop out or refuse to pay, and new members are not recruited in their place. In order for a pyramid scheme to profit, there would have to be a never-ending supply of potential (and willing) participants. In reality, however, the supply of participants is limited, and each new level of participants has a lesser chance of recruiting others and a greater chance of losing money.

*How A Typical Pyramid Is Organized* – A simple pyramid – for example, a five level program built on recruiting by fours – might work like this:

A new recruit would pay \$100 to “join” the organization.

That money would then be disbursed at regular intervals by the company - \$25 to the recruiter, \$25 to the company, and \$50 to the recruiter’s “upline” in the form of \$10 payments to the recruiter’s recruiter, and so on through five levels.

The new recruiter would recover the \$100 “fee” by recruiting four more people, each of whom would pay the recruiter \$25.

From this point, a participant would then make money from all recruiting done by the four recruits and their recruits.

Assuming successful recruiting by the four people down through each of five levels, a participant could (but probably never will) make a cumulative total of \$54,560:

1. \$160 on the first level – e.g., four people each recruiting four others at \$10 a person ( $4 \times 4 = 16 \times \$10 = \$160$ );
2. \$640 on the second level – e.g., 16 each recruiting four persons a \$10 each ( $16 \times 4 = 64 \times \$10 = \$640$ );
3. \$2,560 on the third level ( $64 \times 4 = 256 \times \$10$ );

4. \$10,240 on the fourth level ( $256 \times 4 = 1024 \times \$10$ );
5. \$40,960 on the fifth level ( $1024 \times 4 = 4096 \times \$10$ ).

### *Pyramid Reality*

Pyramids are illegal. Because pyramid sales plans are by their very nature deceptive, they are illegal. There is a real risk that a pyramid operation will be closed down by police and the participants subject to fines and possible arrest.

Pyramids are deceptive. Participants in a pyramid, whether they mean to or not, are deceiving those they recruit. Few would pay to join if the odds stacked against them were fully explained.

Pyramids are losers. Pyramid schemes are based on simple mathematics: many losers pay a few winners.

Pyramids inevitably collapse because it is mathematically impossible to recruit the numbers of people required to support the pyramid. A nine-level pyramid, which is built when each participant gets six "friends" to join, would involve over ten million people!

6  
36  
216  
1,296  
7,776  
46,656  
279,936  
1,679,616  
10,077,696

*Why Would Anyone Pay To Join A Pyramid?*

Pyramid promoters are masters of group psychology. At recruiting meetings they create a frenzied, enthusiastic atmosphere where group pressure and promises of easy money play upon people's greed and fear of missing a good deal. It is difficult to resist this kind of appeal unless you recognize that the scheme is rigged against you.

### *Multi-level Marketing Companies*

Multi-level marketing companies differ from pyramid schemes because they are usually legitimate business opportunities. The sale of legitimate products is what distinguishes multi-level marketing operations from pyramids.

If the emphasis in a multi-level marketing company is **to build a sale force rather than sell the company's products**, it may be an illegal pyramid.

### *The Difference Between Pyramid Schemes And Multi-level Marketing*

Many pyramid promoters attempt to make their schemes look like a multi-level marketing company by using a line of near-worthless products or newsletters and claiming to be in the business of selling them. In pyramid schemes, little or no effort is made to actually market the products. Often there is not even an established market for the products. Rather the "sale" of such merchandise is used as a front for the transactions, which occur only among, and between the operation's distributors.

In pyramid schemes, the emphasis in the sales pitch is on recruiting – building up the organization and the number of participants and on collecting the "start up" fee – not on selling the products. Pyramid schemes want to make money from you, not the product sales.

### ***Pyramid schemes vs. Multi-level Marketing***

Compensation based on recruiting **vs.** Compensation based on sales

Few or no sale to customers **vs.** Sell legitimate products to established markets

Substantial start-up costs **vs.** Generally small start-up fee

Potential to be stuck with large amounts of unsold goods **vs.** Will buy back unsold goods if you decide to quit the business

Make money from you **vs.** Make money with you

### *Protect Yourself*

Take your time. Do not be rushed into any business deal. Show your attorney any contracts you receive from the company. A legitimate business opportunity will not disappear overnight.

Ask questions about the competency and experience of the company and its officers; the products, including the potential market in your area; start-up fees; buy-back provisions; and actual earnings of current distributors.

Get written copies of all available company literature.

Check with others who have experience with the company and its products. Find out if the products are actually being sold to customers.

Investigate and verify all information. Contact Business Registration Division of the Department of Commerce & Consumer Affairs, the Chamber of Commerce, or the Better Business Bureau if you suspect a company may be engaged in an illegal pyramid scheme.

If a pyramid promoter or recruiter tells you that the program has been examined and approved by the Business Registration

Division or any other state agency, know that the claim is **not true!** Hawaii Business Registration Division, of the Department of Commerce & Consumer Affairs does not approve any marketing programs. If such representations are made to you, please notify the Division at (808) 586-2740.